HOUSE BILL 1195:
Sales Tax Exemption/Bankruptcy Proceedings.

2019-2020 General Assembly

Committee:	House Judiciary. If favorable, re-refer to Finance. If favorable, re-refer to Rules, Calendar, and Operations of the House	**Date:**	June 10, 2020
Introduced by:	Reps. Zachary, Sasser	**Prepared by:**	Trina Griffin
Analysis of:	First Edition		Staff Attorney

OVERVIEW: House Bill 1195 would exempt from sales tax items sold pursuant to a receivership proceeding or a bankruptcy proceeding, effective for sales occurring on or after July 1, 2020.

BILL ANALYSIS: This bill addresses a situation where a debtor, or a bankruptcy trustee/administrator or receiver on behalf of a debtor, sells taxable items to the consuming public, which may be individuals or businesses, through the use of a third party, such as an auction company.

Under the law as of February 1, 2020, a sales tax obligation is triggered when the debtor uses a third-party facilitator to conduct the transaction. The reason sales tax is required to be collected is because, unlike the debtor who does not sell this type of property in the ordinary course of their business, the facilitator is considered a retailer because they are in the business of selling tangible personal property.

House Bill 1195 would exempt from sales tax items sold pursuant to a receivership or a bankruptcy proceeding.

CURRENT LAW:

Sales Tax and "Going Out of Business" Auctions. – The retail sale of tangible personal property is subject to sales tax unless there is a specific exemption for the item or for the purchaser. Prior to February 1, 2020, the Department of Revenue had an administrative interpretation with respect to "going out of business" auction sales of fixtures and equipment held onsite at a retail or wholesale business. This type of sale was considered an occasional and isolated sale to the extent the retail or wholesale business was not typically engaged in the business of selling that kind of property and, therefore, was not subject to tax. However, any retail sales of inventory that the business held for resale was still subject to sales tax.

Marketplace Facilitator Change. – Last year, the General Assembly enacted a marketplace facilitator provision, which means that, as of February 1, 2020, a business that sells third party goods in a marketplace and processes payment for the items is a retailer and is required to collect sales tax on behalf of the marketplace seller. This law essentially nullifies the prior administrative interpretation to the extent a third party conducts the sale and collects payment. In the scenario described above, an auction company that sells items of a retail or wholesale business and collects payment for those items on behalf of the retail or wholesale business, regardless of whether the sale is held onsite at the business' location or at the auction company's location, is now considered a retailer and is required to collect sales tax on those sales. This principle applies regardless of whether the auction occurs as part of a bankruptcy proceeding. However, if no third party is used, the sale continues to be exempt from tax as a casual and isolated sale.

Tax Application in Bankruptcy. – Generally speaking, a bankruptcy estate is subject to the same state and local taxes as the property and activities of an individual or business. Under 28 U.S.C. § 960, any officers or agents conducting any business under authority of a United States court are subject to all federal, state, and local taxes applicable to such business to the same extent as if it were conducted by the individual or corporation.[1] This includes the liquidation of assets in a bankruptcy proceeding.[2]

Asset Sales in Bankruptcy. – There are six different types of bankruptcy proceedings.[3] With respect to the sale of assets in a bankruptcy estate, the nature of the sale depends upon the type of bankruptcy, the type of debtor, the type of assets, and any exemptions that might be available to the debtor. Bankruptcy property may be sold either by private sale, through a reorganization plan, or by public auction. There is a high degree of court oversight and participants must adhere to the provisions of the Bankruptcy Code.

Receivership. – A receivership is an equitable remedy that provides for the court appointment of a neutral and independent third party to act on behalf, and for the benefit, of all interested parties. A receivership action is typically initiated by a secured lender, although in some cases, a borrower or its shareholders may seek the appointment of a receiver. The receivership order places the borrower's property under the control of the receiver and delineates the receiver's duties and responsibilities. The appointed receiver typically operates the business and conducts a sale in accordance with court authority and is responsible for distributing the proceeds. A receivership may occur as a step in a company's restructuring process or may arise during a shareholder dispute to complete a project, liquidate assets, or sell a business. Receivership and bankruptcy are not the same, nor are they mutually exclusive; they can occur at the same time, or a receivership may occur without a company being bankrupt.

EFFECTIVE DATE: This bill would become effective for sales occurring on or after July 1, 2020.

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[1] In enacting this legislation, Congress recognized that a business operating under the supervision of a federal court should not have a competitive advantage because of the federal involvement.

[2] The U.S. Supreme Court in *California State Bd. of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844 (1989), held that the assessment of sales and use tax on bankruptcy sales is constitutional. Because the purchaser pays the sales tax, the tax neither discriminates nor imposes an unconstitutional burden upon the federal bankruptcy courts or trustees.

[3] The Bankruptcy Code includes six primary chapters: 7, 9, 11, 12, 13, and 15. Among the more commonly known are Chapters 7, 11, and 13. Chapter 7 is a liquidation proceeding available to consumers and businesses; Chapter 11 allows a business to reorganize its debts while continuing to operate; and Chapter 13 is primarily used by individual wage earners to reorganize their financial affairs under a repayment plan that must be completed within 3-5 years.